DOW THEORY LETTERS INC.

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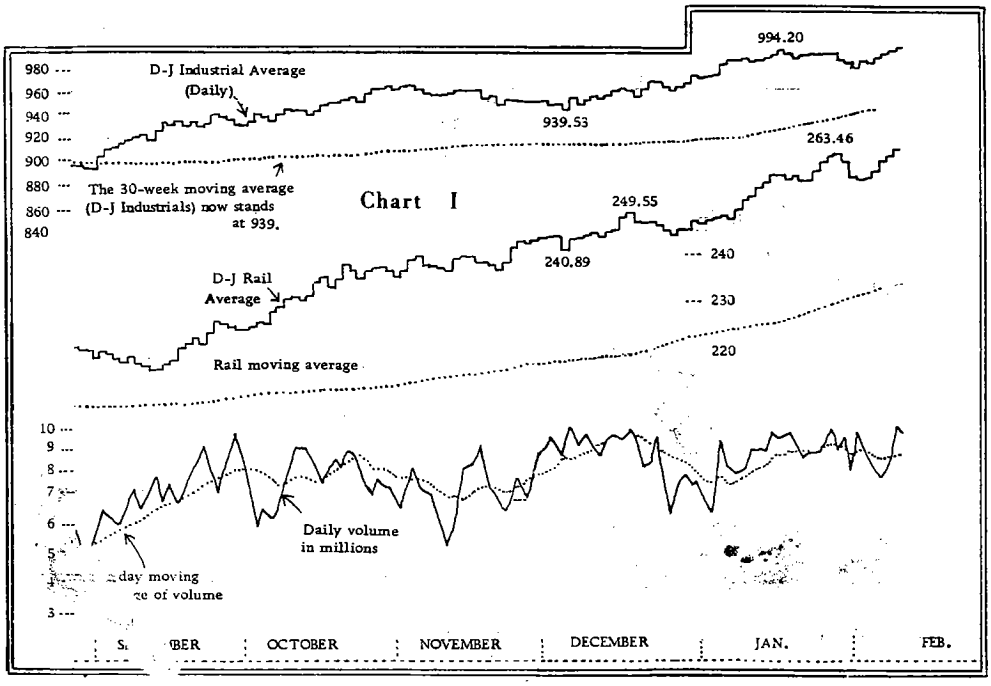
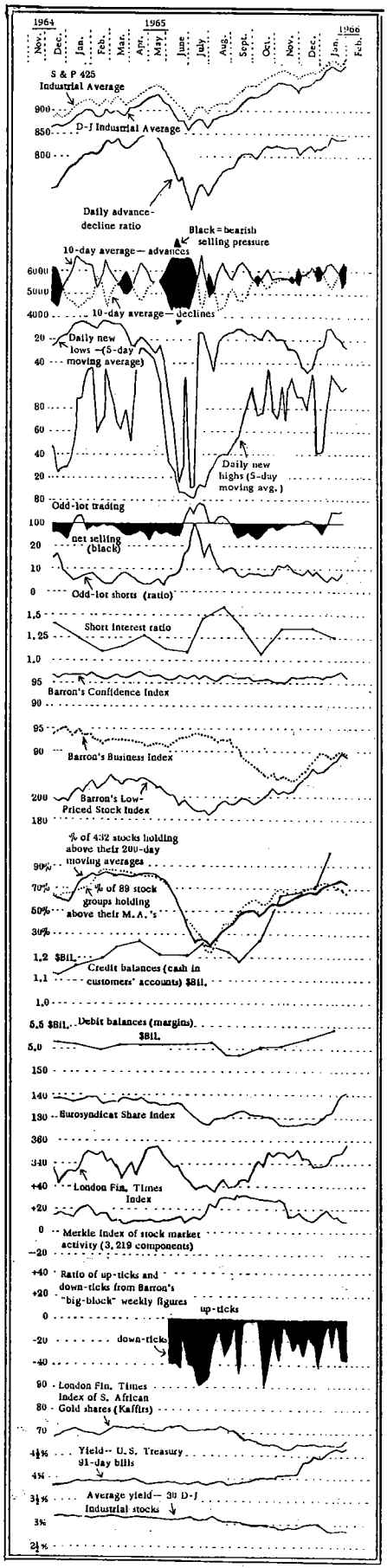
THE MARKET: The Industrial Average has been fluctuating within a 2% range since January 5. The senior Average recorded an all-time high of 994.20 on January 18; it dipped to a low of 975.89 on February 1. Since February 1 the market has been in a rallying phase, and as this Letter is written both Averages are (on an intra-day basis) in new high territory (see Chart 1). A bettering of the January highs of 994.20 (Industrials) and 263.46 (Rails) on a closing basis would constitute an "all clear" signal for the market, at least on a short-term basis. Joint new highs would also mean a reconfirmation of the primary bull trend.

I cannot prove it, but I get the feeling that new highs in the Averages and "above 1000" for Industrials could bring about climactic speculative sentiment on Wall Street. Even now, an aura of "unreality" pervades the market, and a reading of any business periodical such as Business Week or Forbes exposes one to such a flood of bullishness that one is almost tempted to forget that speculative froth and frenzy have, in the past, been the harbingers of a bull market's end.

A few words regarding the excitement of February 8 might be in order. On that day the market sold off intra-day (only to end higher) on the "news" of a two-week old North Vietnam "peace feeler" via India. No one knows for certain how the market would react to a real peace, but it is this observer's opinion that peace is still far away (see Opinions and Comments section). It is also my belief that "on again-off again" peace rumors can be expected from now on. North Vietnam can use peace feelers in an attempt to keep the U.S. off guard, frustrated and hoping. And in the final analysis, Ho Chi Minh has absolutely nothing to lose by appearing ready to negotiate, regardless of whether his intentions are honorable or not.

On the same day (February 8) President Johnson arrived back in the U.S.A. from Honolulu, after conferring with Premier Ky and the U.S. staff in Vietnam. The trip was an obvious attempt to stamp the White House "seal of approval" on the exotic Premier Ky, as well as to provide an answer to critics who claim that we cannot win a strictly military war in Vietnam. The solution to both problems was announced by the President as soon as he got off the plane: (1) The U.S. is now working closely with the new Premier and his staff. (2) Mr. Johnson has decided to bring about a social and economic revolution in South Vietnam and intends to turn that nation into a sort of "Great Society-ette."




1964
1965
1966
S & P 425 Industrial Average
D-J Industrial Average
Daily advance-decline ratio
Black = bearish selling pressure
10-day average — advances
10-day average — declines
Daily new lows (5-day moving average)
Daily new highs (5-day moving avg.)
Odd-lot trading
net selling (black)
Odd-lot shorts (ratio)
Short Interest ratio
Barron's Confidence Index
Barron's Business Index
Barron's Low-Priced Stock Index
% of 432 stocks holding above their 200-day moving averages
% of 89 stock groups holding above their M.A.'s
Credit balances (cash in customers' accounts) $Bil.
Debit balances (margins) $Bil.
Eurosyndicat Share Index
London Fin. Times Index
Merkle Index of stock market activity (3,219 components)
Ratio of up-ticks and down-ticks from Barron's "big-block" weekly figures
up-ticks
down-ticks
London Fin. Times Index of S. African Gold shares (Kaffirs)
Yield -- U.S. Treasury 91-day bills
Average yield — 30 D-J Industrial stocks

Members of Congress, who are still trying to catch up with where the Vietnam war is going, should be greatly interested.

The Composite Chart (page 1) shows the two leading industrial averages at approximate all-time highs. Some selling pressure is indicated from the position of the 10-day average of advances above declines. Reflecting a still-lagging advance-decline ratio, new highs have currently dropped back to the 70-80 area. Odd-lotters continue on the buying side of the market, and this is shaping up as potential technical deterioration. The percentage of stocks holding above the moving averages is now 76%, still well above the critical 50% level. The Merkle Index, which has proved itself a really excellent market barometer, has dropped to plus 8, but it is still above its critical zero level. The negative spread in the yields of the Dow Industrial stocks and the 91-day Treasury bills continues to hold at a spectacular 1.78% in favor of the bills.

Conclusion: No glaring signs of technical weakness yet, but odd-lots should be watched carefully from here on. A second area for scrutiny is the A-D ratio, which has not yet bettered its high of May, 1965.

UTILITIES AND BONDS: Last week the D-J 40 Bond Average dropped to its lowest level since late-1962. At the same time the D-J Utility Average sank to its lowest level since mid-1964. The Utilities and Bonds have two things in common: (1) they tend to be bought and held by investment interests, and (2) they are both affected directly by money rates.

The fact that both of these indices are in pronounced downtrends set me to doing some research. The accompanying chart traces the path of the D-J Utility and 40 Bond Average from 1946 to the present, a period of thirty years. During these thirty years there were only five periods in which both the Utilities and Bonds were in established downtrends. That these periods corresponded with periods of actual or impending monetary maladjustments was apparent, and, in fact, the five shaded areas of the chart checked closely with "danger areas" in bank credit as shown in the work of Mr. Hamilton Bolton (in his "Bank Credit Analyst"). In other words, my conclusion is that whenever monetary forces are powerful enough to cause a pronounced decline in both Utilities and Bonds, such action serves as an advance warning for the entire stock market.

OPINIONS AND COMMENTS: A subscriber has asked me whether "President Johnson is going off the deep end in his appraisal of Vietnam and the U.S. economy—or whether perhaps I am." A week ago our President urged a new half billion dollar global fight on disease, poverty, etc. He proposed this in the face of current massive Great Society spending and in the face of a war which promises to bring on controls and stepped-up taxes across the board. I must confess that I do not know what the President is thinking about.

Listen to this statement from the latest Janeway Report: "If the war were to stop right now, and if the Treasury were not to be out even the cash cost of transportation to bring the troops home, it would need to find closer to $30 billion than $20 billion of new cash to cover the deficit for the current fiscal year and the next." In view of the situation, I ask myself whether I, as President of the U.S., would call for a global anti-poverty program at this time. The answer is a loud "No." What then, is LBJ thinking about? My only conclusion is that the war is becoming so frustrating to the President, and the prospects of continuing war is going to be so damaging to his Great Society plans that he has become like the bankrupt family man who, when told that he has to stop all the nonsense, goes out in a frenzy and buys a new car.

The facts are these: the U.S. is going way over its head in attempting to offer "guns and butter" to the American people. Our President is acting as if this were still a minor war, a low-budget bit of unpleasantness which will not interfere with our domestic programs. The fact is that the Administration's estimate of an approximate $1.6 billion deficit for fiscal 1966-67 is so far off as to be laughable in the eyes of serious economists. Furthermore, events suggest that the President has now gone as far as he is able with Congress. A complacent American public still believes that Johnson has both houses "in his vest pocket." But the shock of realization is about to break into the open.

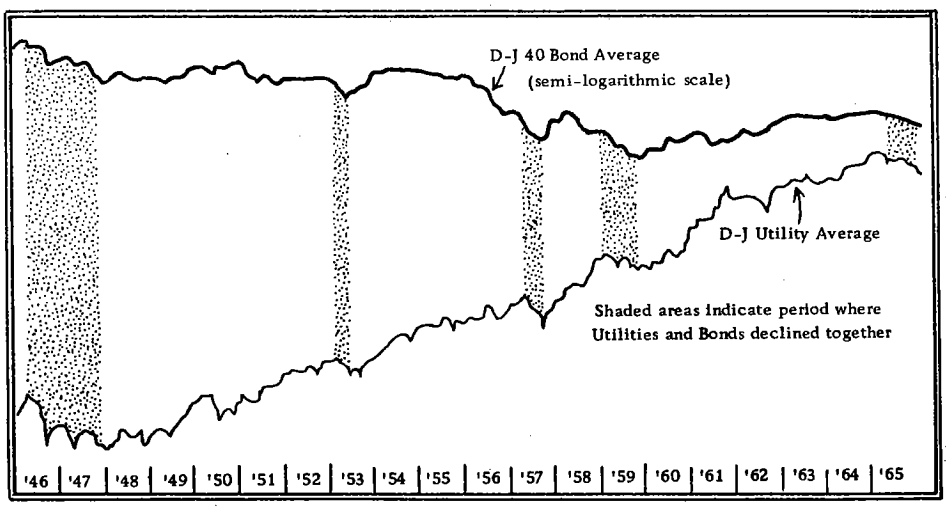
One place where the fight is going to be staged is in the Senate. The subject, Vietnam. The argument, if this is war, why don't we stop playing "footsie" with the American people, and why don't we tell them what this war is really going to cost. And after that, instead of more Great Society spending plans, how are we going to get down to the business of financing this war. The inevitable answer; put the nation on a war footing, raise income taxes and corporate taxes, and cut back on nonessential spending. At any rate, this is the sequence that I see coming up, and if true, it's a fair bet that Wall Street is not going to take to it kindly.

Another subscriber wrote last week to ask: "How can you be sure that the Communists are fighting an economic battle? You've been writing about this in recent Letters, but I think you are greatly exaggerating the sophistication of the Communists."

I have been emphasizing the fact that I believe the Communists are fighting an economic war, and that consequently they are not liable to settle in Vietnam as long as they see the possibility of economic trouble in the U.S. This is just one of the reasons why I have steadfastly maintained that the U.S. must return to fiscal sanity.

Coincidentally, an article by Canadian reporter Mark Gayn appeared in the January 30 New York Times. The article was about Mao Tse-tung and China. Gayn first interviewed Mao in 1947. Does this sound as if the Chinese are interested in an economic war. Listen, this occurred back in 1947.... "We sat in a cave, Mao Tse-tung and I, and we were arguing about the state of the U.S. economy...."Our radio station," Mao said, "monitors the American news broadcasts from Treasure Island (San Francisco bay.) These reports are brought to me, complete with stock market quotations. I study the market reports very closely. One day I'll find in them the first signs of the coming depression. That'll be the beginning of the end for the capitalist system."

My comment: have you ever heard a stronger argument for keeping this nation strong and solvent. Do you believe that the Chinese, who are famed for their patience, have changed their views as expressed by their leader in 1947?



The first such period on the chart began in May, 1946. This timed exactly with the beginning of the major decline in the Industrial Average. The second shaded area started in April, 1953. This was actually three months after the Industrial Average started down (Industrials turned down in January, 1953). The third period began in June, 1957, which was one month prior to the July peak in the Industrial Average.

The fourth shaded area began in April, 1959, and this was nine months before the January, 1960 top in the Industrial Average.

In the present or fifth instance the 40 Bonds turned down in February, 1965. The real decline in Utilities began in April, 1965. Therefore, the joint decline in both components can be said to have started in April, 1965, nine months ago. Based on past history, the decline of Utilities and Bonds together should be taken as a warning of dangerous monetary conditions ahead as well as a warning of unsatisfactory stock market conditions. At very least, the shaded areas identify periods in which informed investment money is distributing or leaving the market.

YOU: There is one subject pertaining to investing which is crucially important but which I have never seen adequately discussed. This is the area of individual investor psychology. The fact is that many knowledgeable individuals who have the talent and "should" be successful in the market are not. The reason they are not is that they attempt to act (contra to) or beyond their psychological capabilities.

One of the first things for the investor to ponder upon is his own psychological make-up. I know any number of men who have followed completely opposite approaches in handling their investments or money-making abilities. But where they were successful, each was fully aware of his own strengths, weaknesses, fears, and hopes. Let me illustrate what I mean.

One friend of mine is a superb judge of market "merchandising." This man does not care what the general market is doing, but he seems intuitively to know the group or the stock which will capture the imagination of Wall Street on the next major advance or during the next bull movement. This man has been uncanny in his selections. He will assume a large position in a stock and wait out his judgment. I would say that his selections are right two out of three times. When he is wrong, he moves out and takes a minor to modest loss. When he is right he makes a great deal of money. Over the years, this "seat-of-the-pants" speculator has become rich. His assets: superb judgment and nerves of steel. I have noted that this fellow treats money very unemotionally, almost as if it were a commodity. When he takes a loss he is not bothered at all. When he makes a "killing," he is equally unimpressed. He spends money with impunity and is generous almost to a fault.

A second friend has a very strong "savings urge" in his personality. He likes to accumulate money, and he is well aware of this trait. In fact, he is secretly pleased when his pals refer to him as "Midas" or "moneybags." Strangely, this man does not particularly enjoy spending money or owning the things money can buy. He likes the outdoors, hiking, hunting and fishing, in fact, all the things money cannot buy. Yet this fellow, very successful by his own standards, has amassed a large amount of money on his own, starting with very little. And he does love the security of bulging bankbooks.

How has he made his money? He recognized the fact that there was a bit of the miser in him, and he realized also that he had the ability to spot bargains, to buy bargains, and even to take large positions in bargains— but they had to be real equity bargains. This fellow was actually a poor "speculator." He did not trust surging markets and stocks that might double in a month. But at a bear market bottom, when stocks were at bargain levels and in the doldrums, this gentleman would be an avid buyer, and as such a superb investor. He possessed great patience and was willing to hold his "bargain purchases" until the market overpriced them. Then, out they would go.

It never bothered this fellow to see stocks exploding during a bull market top area. He knew his own psychology, and he knew that he was a sure loser in a "hot" market. This man was a saver, and he put his money to work in the market only when he felt that the market constituted a much bigger bargain than the banks.

A third friend is a thorough student of the market. He trusts only long-term trends, and he distrusts almost all the advice and information he receives about common stocks. The man is an orthodox Dow Theorist, and he has done exceedingly well over the years. But he seldom trades, and he never cares about anything but his own opinion of the long-term trend of the market.

Distrusting outside information, the fellow purchases stocks pretty much on the basis of group and individual relative strength in selected issues. If there is a "story" behind his selections so much the better. One of this man's peculiarities is that he hates authority or anything which even hints of "going along with the prevailing opinion." Therefore, he tends to buy early in a bull market when the gloom is all-pervading. But he gets nervous as the public climbs aboard, and in his own perverse way he likes to be out well before the public is in. This means that he is on the sidelines early, but this does not bother him. He has made his money (and he has made a lot of it) by being first in and first out. "Just give me a bear market and a new bull market every ten years, and I'll do fine," states this gentleman.

So here are three entirely different types of investors, each able to make money in his own way. And each very liable to lose money following anybody else's method. What do these three men have in common? Each is a hard worker and has spent many hours studying the market from every aspect. Each has respect for knowledge and information, but each has had to pick a particular method which is effective for him. But most important of all, each of these men has a thorough understanding of his own psyche, his own wishes, fears, abilities and shortcomings. These men know what their own personalitites will and will not allow them to do, and they fit their knowledge and their methods into that personal context.

As a final aside, the entire discussion above throws light on my own misgivings regarding "supervised accounts" by investment

services. I know from long experience that one man will buy a stock when it is recommended, hold it for a good profit, then sell it. The next man will buy the same stock, sell it in a panic on the first dip, take a loss and wonder why he ever bought it. This is the reason I have always stressed knowledge in these Letters. Knowledge will, in the end, serve the investor better than all the tips he will ever receive. But when I say "knowledge" I also mean the knowledge the investor possesses of his own psyche and personality. Sit down and think about yourself (instead of the market) for a change. It may make money for you.

STORY OF THE WEEK: The accompanying clip from the New York Times tells the story of 1966's "Non-Magical Fives," refunding notes issued by the Treasury. In today's sinking bond market, 5% interest from the U.S. Treasury creates more consternation than excitement. Savers, like Dicken's Oliver Twist, are asking for "More." The bond market is wondering where it will all end.

STOCKS: Meanwhile, the stock market is roaring on its merry way. The speculator is in the driver's seat, and as I close this Letter the D-J tape shows both Averages "breaking out" to record high ground. I feel that the market, in view of money conditions and in view of prevailing speculative sentiment, is on "thin ice." Nevertheless, certain stocks and groups are worthy of comment, so here goes.

Mack Truck (see Letter 311 and 312) has pushed out of a giant four-year "rectangle." Mack, could earn over $5 in 1966, and is "behind" most of the truck stocks. The "chart measurement" from a rectangle breakout is roughly the depth of the rectangle added to the point of breakout. If the measurement has any validity, Mack possesses the technical base for a move into the 80's.

The Paper Group is particularly interesting at this time. As seen on the chart, this group has been declining in relative strength (i.e., it has been weaker than the general market) for the past five years. This long decline is measured by trendline "A" on the chart. During the past three years a second and steeper decline in relative strength has taken place. But this second trendline ("B") has been reversed over the past month. Big trend reversals start from small ones. The possibility now exists that the paper group is about to reverse the long trendline "A" in relative strength. If this occurs, the group could (in the current type of market) come back with a vengeance. The two papers which I like for speculative are Kimberly-Clark and International Paper (see small weekly charts).

Chart of Mack Truck courtesy of Traders Research, 1431 Pearl St., Alton, Illinois 62003.

Small weekly charts courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas

Paper relative strength chart also courtesy of Traders Research

REFUNDING ENDS WITH A WHIMPER

5% Treasury Notes Slip as Financing Is Completed

By JOHN H. ALLAN

The bond market, like Caesar's Gaul, was divided yesterday into three parts.

In one, the Treasury's $28.8-billion refunding operation was completed, with the new 5 per cent notes slipping to their lowest level since they began trading on a "when-issued" basis last week. Government bond prices fell sharply for the third consecutive day.